Completing the Accounting Cycle

Chapter 4

Wild and Shaw

Fundamental Accounting Principles

25th Edition

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Chapter 4 Learning Objectives

CONCEPTUAL

C1 Explain and prepare a classified balance sheet.

ANALYTICAL

A1 Compute and analyze the current ratio.

PROCEDURAL

P1 Prepare a work sheet and explain its usefulness.

P2 Prepare closing entries and a post-closing trial balance.

P3 *Appendix 4A* – Prepare reversing entries and explain their purpose.

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Learning Objective P1

Prepare a work sheet and explain its usefulness.

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Benefits of a Work Sheet

Reduces risk of errors.

Helps in preparing financial statements.

Not a required report.

Links accounts and adjustments to financial statements.

Shows the effects of proposed transactions.

Learning Objective P1: Prepare a work sheet and explain its usefulness.

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Use of a Work Sheet

Five steps:

Step 1: Enter Unadjusted Trial Balance

Step 2: Enter Adjustments

Step 3: Prepare Adjusted Trial Balance

Step 4: Sort Adjusted Trial Balance Amounts to Financial Statements

Step 5: Total Statement Columns, Compute Income or Loss, and Balance Columns

Learning Objective P1: Prepare a work sheet and explain its usefulness.

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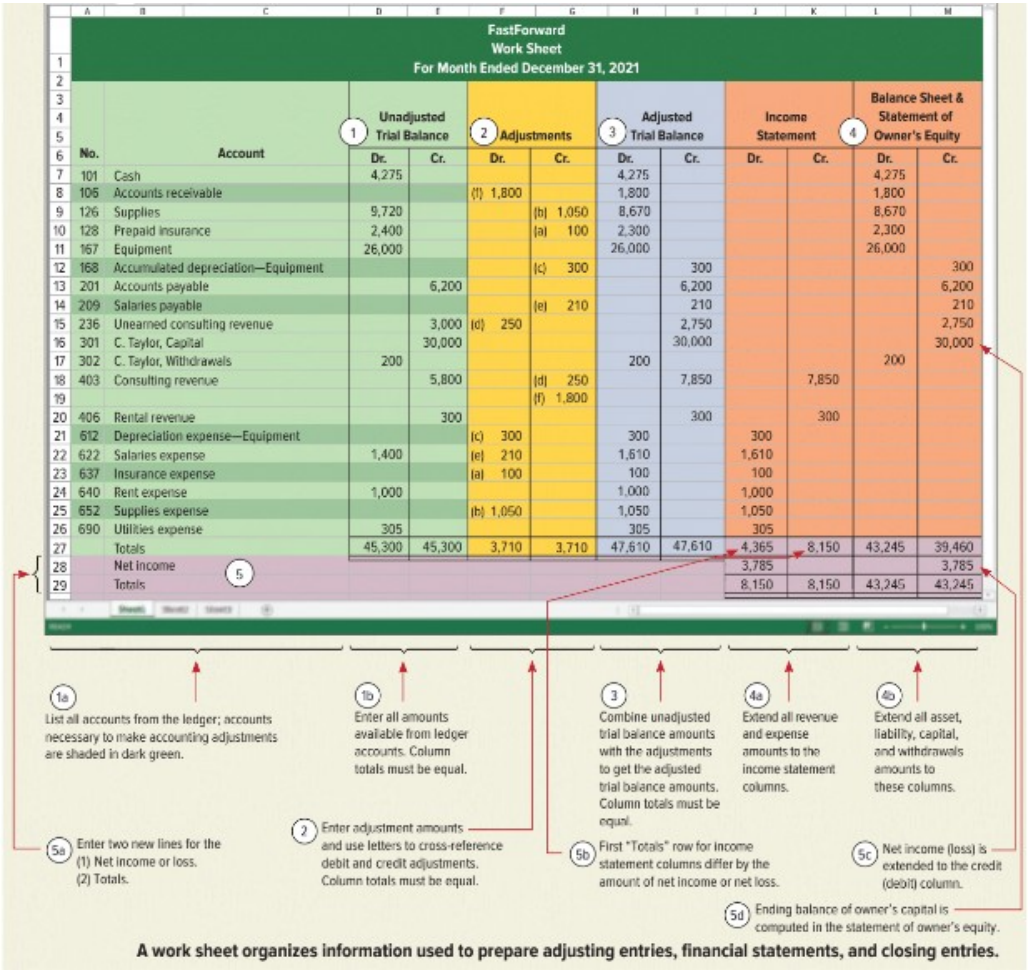
Work Sheet Example



FastForward
Work Sheet
For Month Ended December 31, 2021

No.	Account	1 Unadjusted Trial Balance Dr.	1 Unadjusted Trial Balance Cr.	2 Adjustments Dr.	2 Adjustments Cr.	3 Adjusted Trial Balance Dr.	3 Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.	4 Balance Sheet & Statement of Owner's Equity Dr.	4 Balance Sheet & Statement of Owner's Equity Cr.
101	Cash	4,275				4,275				4,275	
105	Accounts receivable			(f) 1,800		1,800				1,800	
126	Supplies	9,720			(b) 1,050	8,670				8,670	
128	Prepaid insurance	2,400			(a) 100	2,300				2,300	
167	Equipment	26,000				26,000				26,000	
168	Accumulated depreciation—Equipment				(c) 300		300				300
201	Accounts payable		6,200				6,200				6,200
209	Salaries payable				(e) 210		210				210
236	Unearned consulting revenue		3,000	(d) 250			2,750				2,750
301	C. Taylor, Capital		30,000				30,000				30,000
302	C. Taylor, Withdrawals	200				200				200	
403	Consulting revenue		5,800		(d) 250		7,850		7,850		
					(f) 1,800						
406	Rental revenue		300				300		300		
612	Depreciation expense—Equipment			(c) 300		300		300			
622	Salaries expense	1,400		(e) 210		1,610		1,610			
637	Insurance expense			(a) 100		100		100			
640	Rent expense	1,000				1,000		1,000			
652	Supplies expense			(b) 1,050		1,050		1,050			
690	Utilities expense	305				305		305			
	Totals	45,300	45,300	3,710	3,710	47,610	47,610	4,365	8,150	43,245	39,460
	Net income							3,785			3,785
	Totals							8,150	8,150	43,245	43,245

5 Net income

1a List all accounts from the ledger; accounts necessary to make accounting adjustments are shaded in dark green.

1b Enter all amounts available from ledger accounts. Column totals must be equal.

3 Combine unadjusted trial balance amounts with the adjustments to get the adjusted trial balance amounts. Column totals must be equal.

4a Extend all revenue and expense amounts to the income statement columns.

4b Extend all asset, liability, capital, and withdrawals amounts to these columns.

5a Enter two new lines for the (1) Net income or loss. (2) Totals.

2 Enter adjustment amounts and use letters to cross-reference debit and credit adjustments. Column totals must be equal.

5b First "Totals" row for income statement columns differ by the amount of net income or net loss.

5c Net income (loss) is extended to the credit (debit) column.

5d Ending balance of owner's capital is computed in the statement of owner's equity.

A work sheet organizes information used to prepare adjusting entries, financial statements, and closing entries.

Exhibit 4.1

Learning Objective P1: Prepare a work sheet and explain its usefulness.

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Learning Objective P2

Prepare closing entries and a post-closing trial balance.

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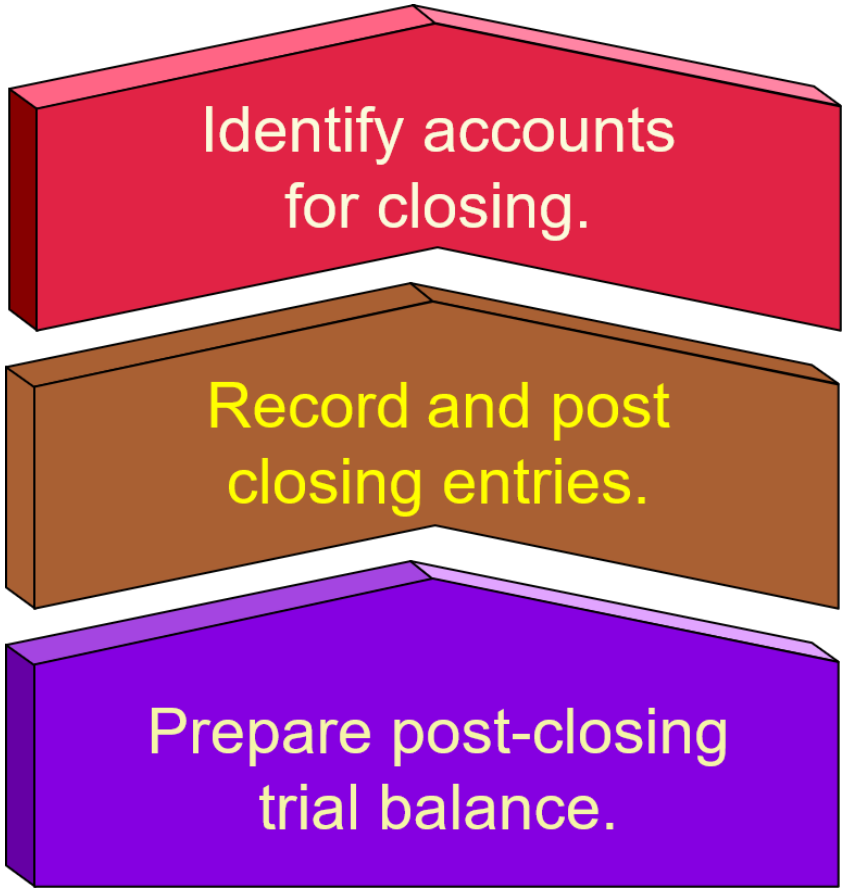
Closing Process

1. Resets revenue, expense, and withdrawal account balances to zero at the end of the period.

2. Updates the balance in the owner's capital account to match the amount reported on the statement of owner's equity and the balance sheet.



Learning Objective P2: Prepare closing entries and a post-closing trial balance.

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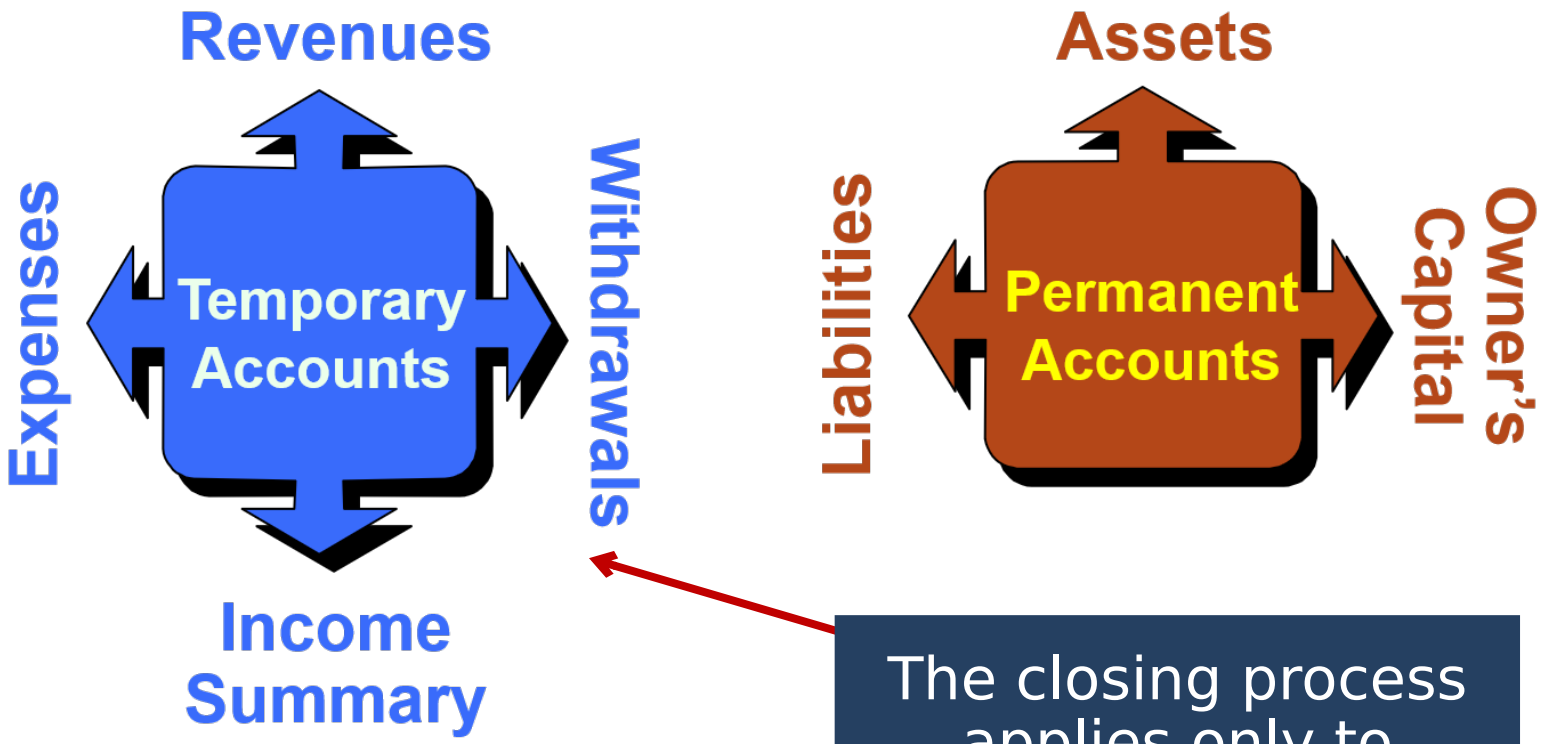
Temporary and Permanent Accounts



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Recording Closing Entries

1. Close Credit Balances in Revenue Accounts to Income Summary.
2. Close Debit Balances in Expense accounts to Income Summary.
3. Close Income Summary account to Owner's Capital.
4. Close Withdrawals to Owner's Capital.

Learning Objective P2: Prepare closing entries and a post-closing trial balance.

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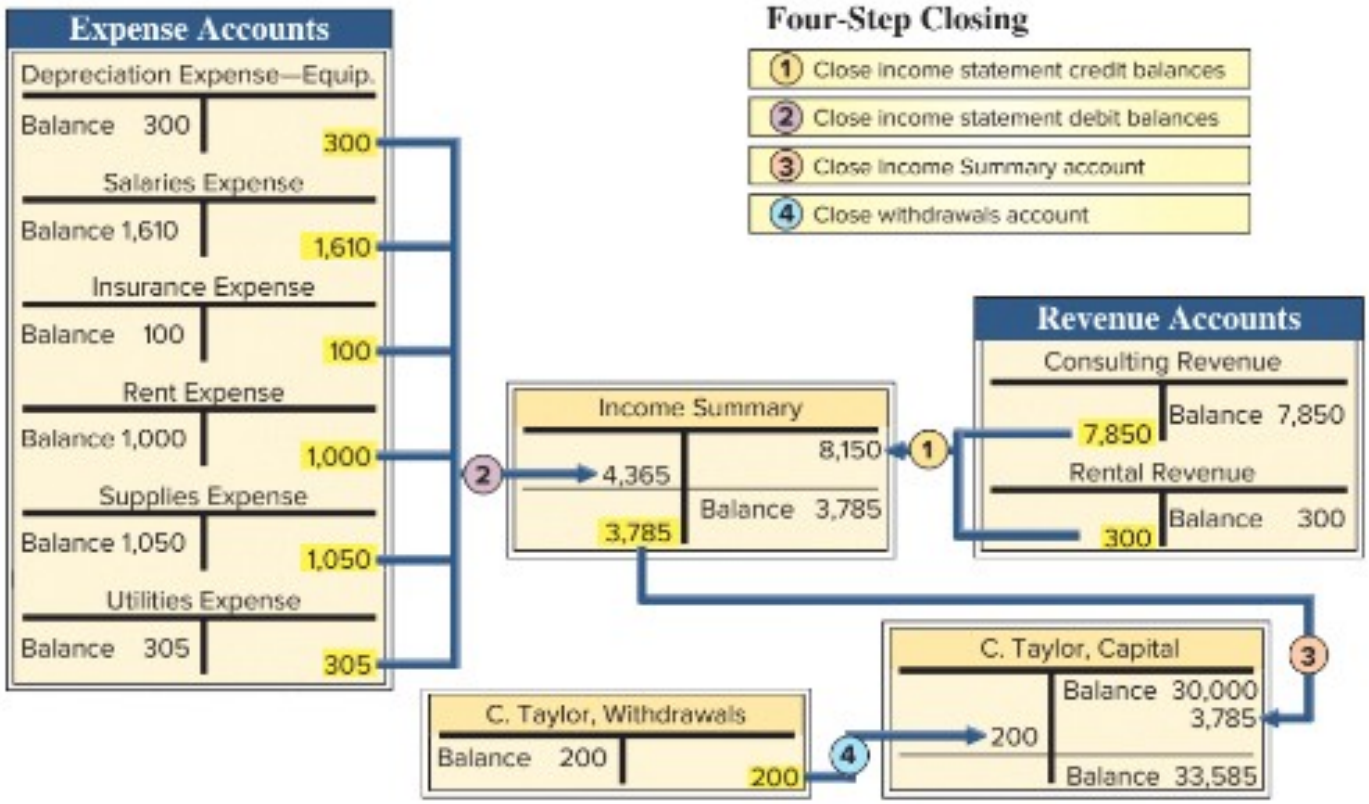
Recording Closing Entries Example

Exhibit 4.3



Learning Objective P2: Prepare closing entries and a post-closing trial balance.

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Post-Closing Trial Balance

- List of permanent accounts and their balances after posting closing entries.
- Total debits and credits must be equal.
- All temporary accounts have a zero balance.

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Post-Closing Trial Balance Example

Exhibit 4.6

FASTFORWARD Post-Closing Trial Balance December 31, 2021		
	Debit	**Credit**
Cash	$ 4,275	
Accounts receivable	1,800	
Supplies	8,670	
Prepaid insurance	2,300	
Equipment	26,000	
Accumulated depreciation—Equipment .		$ 300
Accounts payable		6,200
Salaries payable		210

Learning Ob
balance.

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Accounting Cycle

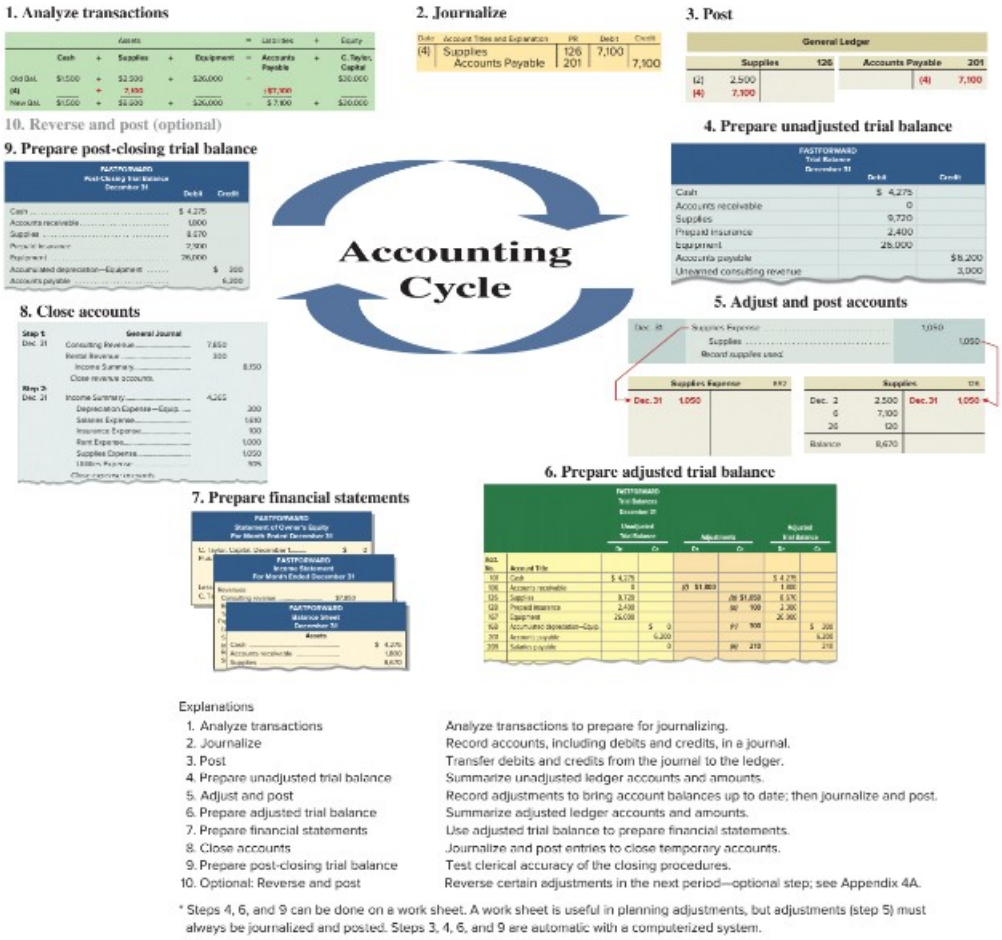

Exhibit 4.7

Explanations	
1. Analyze transactions	Analyze transactions to prepare for journalizing.
2. Journalize	Record accounts, including debits and credits, in a journal.
3. Post	Transfer debits and credits from the journal to the ledger.
4. Prepare unadjusted trial balance	Summarize unadjusted ledger accounts and amounts.
5. Adjust and post	Record adjustments to bring account balances up to date; then journalize and post.
6. Prepare adjusted trial balance	Summarize adjusted ledger accounts and amounts.
7. Prepare financial statements	Use adjusted trial balance to prepare financial statements.
8. Close accounts	Journalize and post entries to close temporary accounts.
9. Prepare post-closing trial balance	Test clerical accuracy of the closing procedures.
10. Optional: Reverse and post	Reverse certain adjustments in the next period—optional step; see Appendix 4A.

* Steps 4, 6, and 9 can be done on a work sheet. A work sheet is useful in planning adjustments, but adjustments (step 5) must always be journalized and posted. Steps 3, 4, 6, and 9 are automatic with a computerized system.

Learning Objective P2: Prepare closing entries and a post-closing trial balance.

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Learning Objective C1

Explain and prepare a classified balance sheet.

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Classified Balance Sheet

Assets	Liabilities and Equity
Current assets	Current liabilities
Noncurrent assets	Noncurrent liabilities
Long-term investments	Equity
Plant assets	

Exhibit 4.8

Current items are expected to come due (collected and owed) within the longer of one year or the company's normal operating cycle.

Most operating cycles are less than one year, so most companies use a one year period in deciding what assets and liabilities are current.

Learning Objective C1: Explain and prepare a classified balance sheet.

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Classified Balance Sheet Example

Exhibit 4.9

SNOWBOARDING COMPONENTS
Balance Sheet
December 31, 2021

Assets			Liabilities		
Current assets			**Current liabilities**		
Cash		$ 6,500	Accounts payable	$ 15,300	
Accounts receivable		6,500	Wages payable	3,200	
Merchandise inventory		27,500	Unearned revenue	10,500	
Prepaid insurance		2,400	Total current liabilities		$ 29,000
Total current assets		$ 42,900	**Long-term liabilities**		
Long-term investments			Notes payable (due in ten years)	40,000	
Notes receivable (due in three years)		1,500	Total long-term liabilities		150,000
Investments in stocks and bonds		66,000	Total liabilities		179,000
Total long-term investments		67,500			
Plant assets					
Equipment	203,200		**Equity**		
			T. Hawk,		164,800

Current Assets

Current assets are expected to be sold, collected, or used within one year or the company's operating cycle, whichever is longer.

Examples: cash, short-term investments, accounts receivable, short-term notes receivable, merchandise inventory, and prepaid expenses.

Learning Objective C1: Explain and prepare a classified balance sheet.

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Long-Term Investments

Long-term investments are expected to be held for more than one year or the operating cycle.

Examples: notes receivable and investments in stocks and bonds expected to be held for more than the longer of one year or the operating cycle.

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Plant Assets

Plant assets are tangible long-lived assets used to produce or sell products and services.

Examples: equipment, machinery, buildings, and land that are used to sell products and services.

Also called property, plant, and equipment (PP&E) or fixed assets.

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Intangible Assets

Intangible assets are long-term assets that benefit business operations but lack physical form.

Examples: patents, trademarks, copyrights, franchises, and goodwill.

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Current Liabilities

Current liabilities are liabilities due within the longer of one year or the company's operating cycle.

Examples: accounts payable, wages payable, taxes payable, interest payable, and unearned revenues.

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Long-Term Liabilities

Long-term liabilities are liabilities not due within the longer of one year or the company's operating cycle.

Examples: notes payable, mortgages payable, bonds payable, and lease obligations.

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Equity

Equity is the owner's claim on the assets.

For a proprietorship, reported in owner's capital account.

Equity is not separated into current and noncurrent categories.

Learning Objective C1: Explain and prepare a classified balance sheet.

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Learning Objective A1

Compute and analyze the current ratio.

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Current Ratio

Helps assess the company's ability to pay its debts in the near future

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Exhibit 4.10

Company	$ millions	Current Year	1 Year Ago	2 Years Ago
Costco	Current assets.	$23,485	$20,289	$17,317
	Current liabilities.	$23,237	$19,926	$17,495
	Current ratio.	1.01	1.02	0.99

Exhibit 4.11

Learning Objective A1: Compute and analyze the current ratio.

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Learning Objective P3

Prepare reversing entries and explain their purpose.

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Appendix 4A – Reversing Entries

Reversing entries are optional. They reverse the debits and credits of adjusting entries involving accrued revenues and accrued expenses. The purpose is to simplify recordkeeping.

Let’s see how the accounting for our payroll accrual will be handled with and without reversing entries.

Learning Objective P4: Prepare reversing entries and explain their purpose.

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Reversing Entries 1

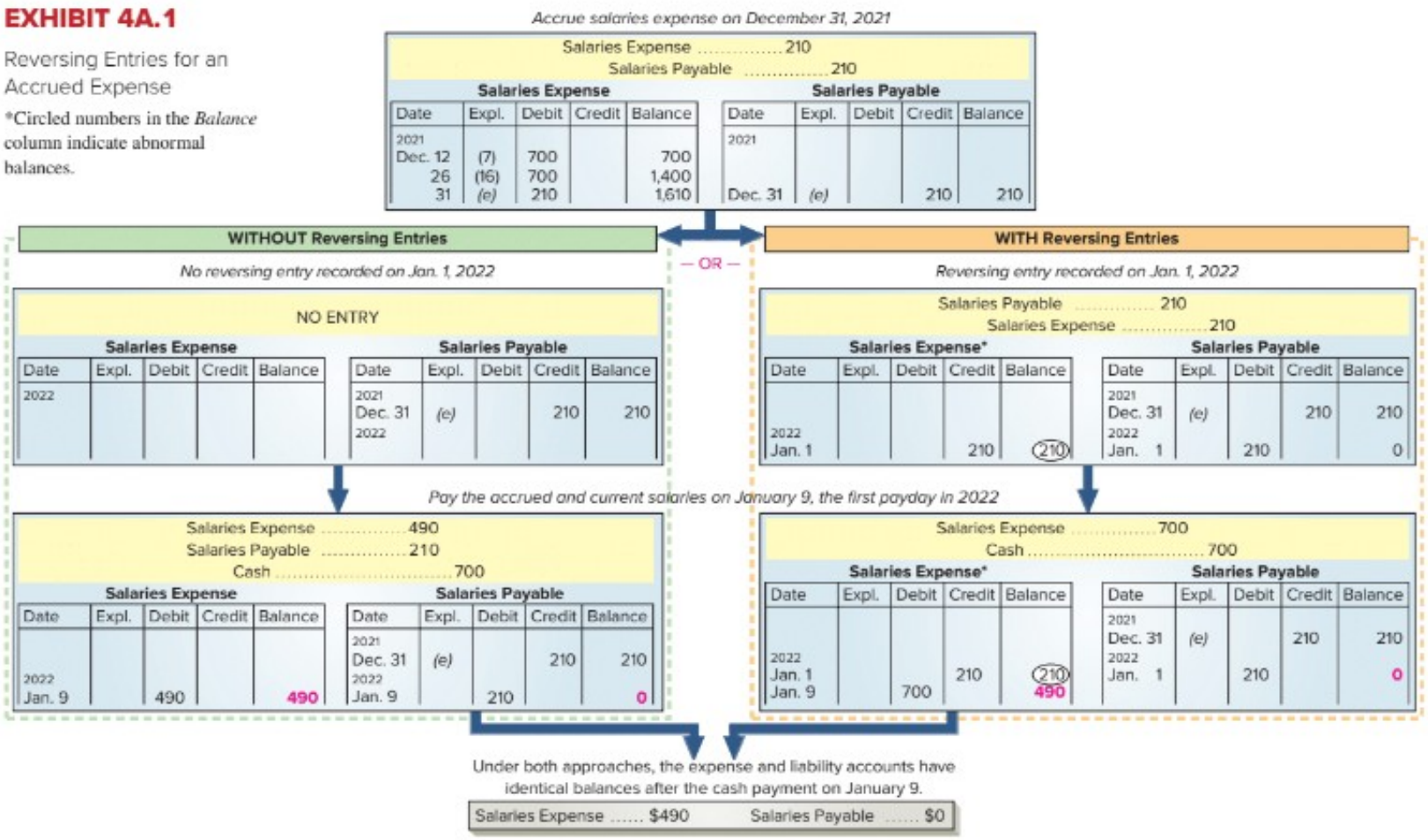
EXHIBIT 4A.1
Reversing Entries for an Accrued Expense
*Circled numbers in the Balance column indicate abnormal balances.
Accrue salaries expense on December 31, 2021
Salaries Expense 210
Salaries Payable 210
Salaries Expense
Date | Expl. | Debit | Credit | Balance
2021
Dec. 12 | (7) | 700 | | 700
26 | (16) | 700 | | 1,400
31 | (e) | 210 | | 1,610
Salaries Payable
Date | Expl. | Debit | Credit | Balance
2021
Dec. 31 | (e) | | 210 | 210
WITHOUT Reversing Entries
No reversing entry recorded on Jan. 1, 2022
NO ENTRY
Salaries Expense
Date | Expl. | Debit | Credit | Balance
2022
Salaries Payable
Date | Expl. | Debit | Credit | Balance
2021
Dec. 31 | (e) | | 210 | 210
2022
Pay the accrued and current salaries on January 9, the first payday in 2022
Salaries Expense 490
Salaries Payable 210
Cash 700
Salaries Expense
Date | Expl. | Debit | Credit | Balance
2022
Jan. 9 | | 490 | | 490
Salaries Payable
Date | Expl. | Debit | Credit | Balance
2021
Dec. 31 | (e) | | 210 | 210
2022
Jan. 9 | | 210 | | 0
— OR —
WITH Reversing Entries
Reversing entry recorded on Jan. 1, 2022
Salaries Payable 210
Salaries Expense 210
Salaries Expense*
Date | Expl. | Debit | Credit | Balance
2022
Jan. 1 | | | 210 | (210)
Salaries Payable
Date | Expl. | Debit | Credit | Balance
2021
Dec. 31 | (e) | | 210 | 210
2022
Jan. 1 | | 210 | | 0
Salaries Expense 700
Cash 700
Salaries Expense*
Date | Expl. | Debit | Credit | Balance
2022
Jan. 1 | | | 210 | (210)
Jan. 9 | | 700 | | 490
Salaries Payable
Date | Expl. | Debit | Credit | Balance
2021
Dec. 31 | (e) | | 210 | 210
2022
Jan. 1 | | 210 | | 0
Under both approaches, the expense and liability accounts have identical balances after the cash payment on January 9.
Salaries Expense $490
Salaries Payable $0

Learning Objective P3: Prepare reversing entries and explain their purpose.

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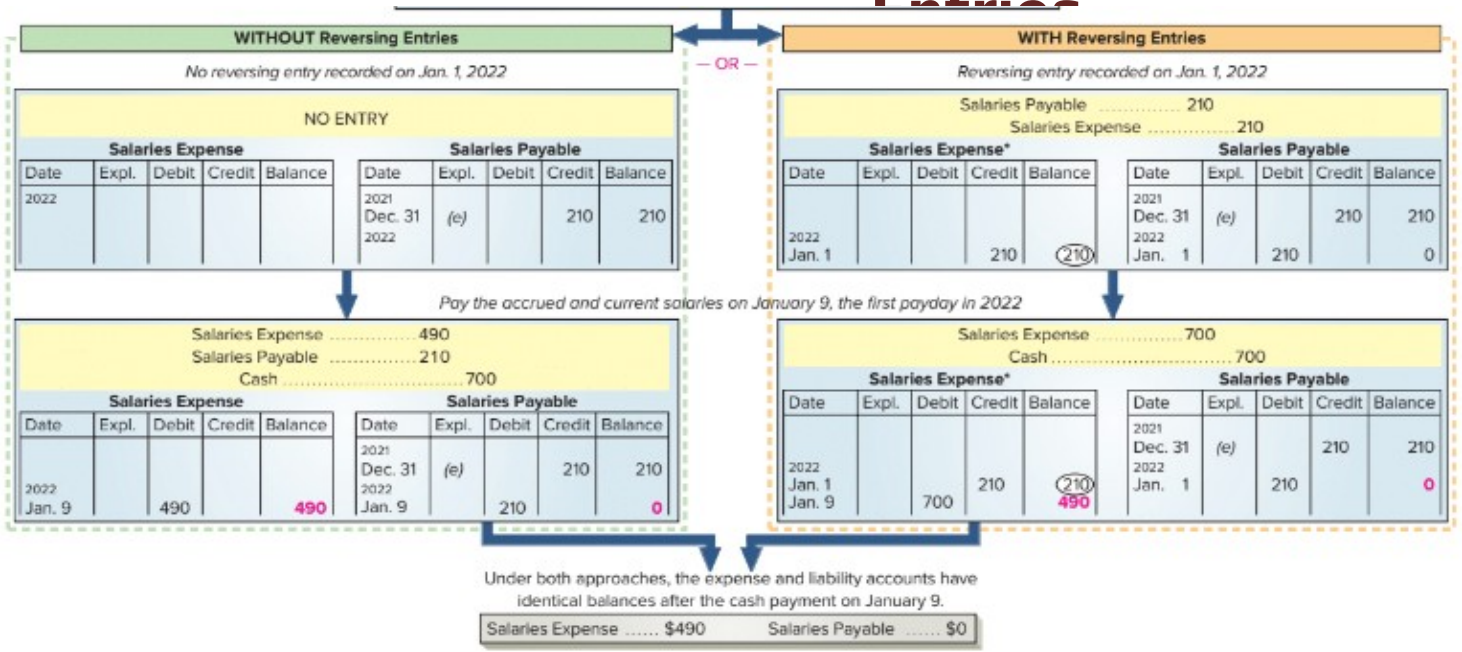
Reversing Entries 2

Exhibit 4A.1

Without Reversing Entries

With Reversing Entries


WITHOUT Reversing Entries
No reversing entry recorded on Jan. 1, 2022
NO ENTRY
Salaries Expense
Salaries Payable
Pay the accrued and current salaries on January 9, the first payday in 2022
Salaries Expense 490
Salaries Payable 210
Cash 700
— OR —
WITH Reversing Entries
Reversing entry recorded on Jan. 1, 2022
Salaries Payable 210
Salaries Expense 210
Salaries Expense 700
Cash 700
Under both approaches, the expense and liability accounts have identical balances after the cash payment on January 9.
Salaries Expense $490
Salaries Payable $0

Learning Objective P3: Prepare reversing entries and explain their purpose.

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End of Chapter 4

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